No. 14047

IN THE

United States Court of Appeals For the Ninth Circuit

RALPH H. EATON FOUNDATION, *Petitioner*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*

On Petition for Review of the Decision of the Tax Court of the United States

BRIEF FOR THE RESPONDENT

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OPINION BELOW

The memorandum opinion of the Tax Court (R. 28-41) is not reported.

JURISDICTION

The Commissioner determined deficiencies in income tax for the period from March 12, 1947, to January 31, 1948, and for the fiscal year ending January 31, 1949, and added penalties for both periods. The notice of deficiencies was mailed to taxpayer on July

21, 1950, and the petition for review by the Tax Court was filed on October 12, 1950. Accordingly the petition was filed within the 90-day period allowed by Section 272 of the Internal Revenue Code. After hearing on such petition, the Tax Court entered its decision on June 8, 1953, determining deficiencies in income tax in the total amount of $24,486.93 but held that no penalties were due. (R. 42.) A petition for review by this Court was filed on August 17, 1953.[1] The Court accordingly has jurisdiction of the case under Section 1141 (a) of the Internal Revenue Code, as amended by Section 36 of the Act of June 25, 1948.

QUESTION PRESENTED

Whether the Tax Court correctly held that the taxpayer, a corporation which has been engaged in ordinary business activities for profit, is not entitled to exemption from income tax under Section 101(6) of the Internal Revenue Code.

STATUTES AND REGULATIONS INVOLVED

The statutes and Regulations involved are set forth in Appendix A, *infra.*

STATEMENT

The pertinent facts as found by the Tax Court are as follows (R. 29-38):

Taxpayer is a corporation organized under the laws of Arizona in March 1947. Taxpayer's incorporators

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[1] The dates which are given above without record citations do not appear in the record but they have been verified by reference to the Tax Court's records.

were Ralph H. Eaton, Frances M. Eaton, his wife, and Thomas H. Kent, Jr. They were elected directors and also president, vice president and secretary-treasurer, respectively, which positions they still held in May 1952. Taxpayer has no capital stock outstanding and the articles of incorporation expressly prohibit the issuance of capital stock. (R. 29.)

Taxpayer's articles of incorporation describe the nature and purpose of its proposed business as (R. 29)—

> To foster and promote Christian, religious, charitable and educational enterprises.
>
> * * * * *
>
> This corporation * * * does not contemplate pecuniary gain or profit to the members thereof * * *

The articles also set forth a detailed doctrinal statement which provide (R. 29-30):

> Article IV.
>
> The foundation upon which this corporation is based is a heart-conviction of the truth of the following Doctrinal Statement:
>
> 1. We believe that the entire Bible is the inspired and inerrant word of God, the only infallible rule of faith and practice.
>
> 2. We believe that the Lord Jesus Christ is the only begotten Son of God, conceived by the Holy Spirit and born of the Virgin Mary.

3. We believe in the literal, bodily, physical and premillennial return of Jesus Christ.

4. We believe in the sacrificial and vicarious death of the Lord Jesus Christ on the cross and that He thereby made perfect substitutionary atonement for the sin of the world.

5. We believe that all men are sinners and in an eternally lost condition apart from the saving grace of the Lord Jesus Christ.

6. We believe that acceptance into the family of God and eternal salvation can only be secured by believing in and by faith accepting and receiving the Lord Jesus Christ as personal Sin-bearer, Lord and Saviour.

The articles direct that each director must reaffirm the doctrinal statement annually, in writing, and that such reaffirmance must be filed with taxpayer's permanent records. (R. 30.)

Ralph H. Eaton, who joined the Capital Christian Church of Phoenix, Arizona, in 1931, and has been closely associated with a number of religious organizations, became interested in such a foundation in 1944 when he attended the international convention of the Christian Business Men's Committee in New York City. While there he heard a speech by an industrialist who had contributed money to charities and Christian work through his own charitable foundation, and he later read a book by the same individual which further described the part played by religion in his business pursuits. At that time Eaton's principal source of

income was the Eaton Fruit Company, a business owned by him and his two brothers. (R. 31.)

Kent, after graduating from Butler University, went to work for the Eaton Fruit Company in 1941, and joined the Eaton-Heiskell Construction Company in 1945 as bookkeeper. In January 1948 he became a salaried employee of taxpayer. His duties were to act as office manager, bookkeeper and business manager, and to keep taxpayer's minute book. Mr. and Mrs. Eaton had known Kent since about 1937, having been members of the same church and of many religious and charitable organizations. (R. 31-32.)

For about two years prior to the organization of taxpayer, Kent and the Eatons discussed its formation and, in or about February, 1947, they secured Robert Weaver, an attorney of Phoenix, Arizona, to draw up the articles of incorporation except the doctrinal statement which the three incorporators drafted after numerous deliberations. (R. 32.)

In March 1947 Mr. and Mrs. Eaton transferred to taxpayer certain farm and office equipment in order to enable it to engage in farming business operations. This equipment had cost $1,843.66. The Eatons also transferred to taxpayer at about that time all their right, title and interest in certain growing crops on which they had advanced to the date of transfer a sum of $3,520.79, and taxpayer agreed to repay that sum to the Eatons. (R. 32.)

In the spring of 1945, Eaton purchased 110 acres of land in Phoenix, Arizona, and transferred such land to a corporate trustee pursuant to two trust agreements. This land was subdivided into lots and, after

selling one-tenth interest to George Heiskell, the Eatons transferred their remaining nine-tenths interest in the trusts to taxpayer in April 1947. The net cost of their interest was $27,410.62. On January 1, 1948, Eaton also transferred his partnership interest in Eaton & Heiskell Construction Company, a business engaged primarily in contracting the construction of small residences. The total cost to the Eatons of transfers to taxpayer during its first fiscal year aggregated approximately $50,000. (R. 32-33.)

During the periods involved here, taxpayer was engaged in farming, selling real estate, constructing small residences, and selling sport clothes. (R. 33.) Its activities in these four businesses are as follows:

1. Taxpayer's farming operations were conducted on land held under five leases. Under a lease dated March 20, 1947, taxpayer leased from Eaton 80 acres of land known as the L Avenue Ranch for one year beginning February 1, 1947, at a rental of $40 per acre per year, and this lease was renewed for another year at the same rental. Taxpayer also leased land known as the Swant Ranch from E. H. Swant for one year beginning July 1, 1947, at a rental of $30 per acre per year. On or about July 1, 1948, Eaton purchased the Swant Ranch and entered into a new lease between himself and taxpayer for one year beginning July 1, 1948, at a rental of $40 per acre per year. (R. 33-34.)

On or about April 1, 1948, Eaton purchased 40 acres of farm land on Ramona Road, Phoenix, Arizona, and leased 35 acres thereof to taxpayer for a period of one year beginning April 1, 1948, at a rental of $40 per acre

per year. Taxpayer also leased a ranch known as the Rousseau Ranch for six months beginning July 1, 1948, at $60 per acre per year, and the Mann Ranch for one year beginning August 1, 1947, at a rental of $35 per acre. The latter lease was renewed at its expiration for an additional six months at $45 per acre per year. (R. 34.)

Neither the manager of taxpayer's farming operations nor the lessors of the land referred to are related to Kent or the Eatons, nor do they have any interest in taxpayer. (R. 34.)

Taxpayer's net income from its farming operations during the periods in controversy was as follows (R. 34):

3/12/47 to 1/31/48	$16,731.14
2/ 1/48 to 1/31/49	7,095.23

The L Avenue Ranch was formerly leased by Eaton to the Eaton Fruit Company at the same rental later paid by taxpayer. Eaton charged taxpayer for the rental of his lands because of financial necessity. He had purchased the Swant Ranch and Ramona land on an installment basis, and his combined payments per year, including amortization of principal on these properties, were more than three times the rental he received from taxpayer. He also expended substantial sums in improving these properties. (R. 35.)

2. Taxpayer's real estate operations consisted of selling subdivided lots contained in the land which had been subject to the trust agreements. Taxpayer's net

income from these operations for the periods in controversy was as follows (R. 35):

3/1/47 to 1/31/48	$49,089.41
2/1/48 to 1/31/49	2,784.06

3. In 1945 Eaton entered into a partnership with George M. Heiskell under the name of Eaton & Heiskell Construction Company, to engage in general contracting and in January 1948 taxpayer purchased Heiskell's interest in the company for its book value. Simultaneously Eaton donated his interest in the company to taxpayer and taxpayer has operated the business under its original name since that time. Heiskell was employed to manage the business for taxpayer under a written contract, the terms of which provided for one year of employment beginning January 1, 1948. The term was extended in fact for an additional month, to January 31, 1949. Heiskell is not related to the Eatons or to Kent. (R. 35-36.) Taxpayer derived the following net income from its construction operations during the periods in controversy (R. 36):

3/12/47 to 1/31/48	(none)
2/ 1/48 to 1/31/49	$7,551.52

4. On June 2, 1947, pursuant to authorization of its directors, taxpayer acquired the distributorship within the State of Arizona of certain sport clothes manufactured by one C. F. Smith. Taxpayer operated this business under the name of "Hollywood Sportogs of Arizona", and was to receive 10 per cent of all gross sales. This business activity was discontinued on June

1, 1948, due to management difficulties and lack of sales. Taxpayer incurred net losses from this business during the periods in controversy as follows (R. 36):

3/12/47 to 1/31/48 ..... ($533.83)
2/ 1/48 to 1/31/49 ..... (134.39)

Taxpayer's directors discussed its business activities fully before undertaking each of them, and were completely agreed on taxpayer's course of action in all cases. (R. 36.)

At a meeting of the directors on May 1, 1947, taxpayer adopted a list of 26 named beneficiaries engaged in charitable or religious work to whom its funds would be made available, in its discretion. It also provided for contributions of not more than $10 by taxpayer's president to miscellaneous organizations engaged in charitable and religious work, without necessity for consulting the board. At a board meeting held on January 1, 1949, seven additional named beneficiaries were added to taxpayer's list. This list was compiled after a thorough investigation of the activities of each organization. Taxpayer kept a file on each. All beneficiaries had to be and are engaged in activities which carried out the purposes and ideas for which taxpayer was established. None of them is engaged in the carrying on of propaganda or in efforts to influence legislation. None of them has any private, beneficial or personal interest in taxpayer. No beneficiaries are individuals; any names of individuals on taxpayer's list appear as representatives of an organization. (R. 36-37.) During the periods in controversy,

taxpayer made contributions to beneficiaries as follows (R. 37):

3/12/47 to 1/31/48	$4,240
2/ 1/48 to 1/31/49	2,310

In addition to monetary contributions, taxpayer rendered consultative services to some beneficiaries. Taxpayer's officers assisted in planning two church building programs. (R. 37.)

Except for rental payments, interest on money borrowed, payment for costs advanced by Eaton on certain equipment and growing crops, and repayment of loans, taxpayer paid nothing of tangible value to Eaton or to his family during the instant taxable years. Eaton rendered substantial services to taxpayer. The only compensation received by Kent is a weekly salary of $100, paid since January 1, 1948, when he began devoting his full time to taxpayer's affairs. He has rendered substantial services to taxpayer. (R. 37.)

The Tax Court held that the taxpayer was not entitled to exemption. Accordingly it decided that there are deficiencies in income tax for the period from March 12, 1947, to January 31, 1948, of $23,263.05, and for the year ending January 31, 1949, $1,223.88. (R. 42.)

SUMMARY OF ARGUMENT

1. The Tax Court correctly held that the taxpayer is not entitled to exemption under Section 101 (6) of the Internal Revenue Code, which requires a corporation to show, among other things, that it has been "organized and operated exclusively" for religious,

charitable or educational purposes. We submit that this means that exemption should be denied unless the organization itself has a religious, charitable or educational function and such function should be its sole purpose. Consequently a corporation organized and operated as an ordinary commercial business enterprise, as was the taxpayer here, cannot meet the statutory requirement for even if it is conceded that it has more than one purpose, it clearly has a business purpose and the presence of such purpose precludes it from showing that it was organized and operated *exclusively* for any of the approved purposes set out in Section 101 (6).

2. The correctness of the Tax Court's interpretation is further shown by the provisions of Code Section 101(14). Congress was aware that the net earnings of an organization which is not itself organized and operated exclusively for any approved purpose might be destined for exempt corporations. Nevertheless it has limited the exemption in such cases to corporations whose sole function is to hold title to property, collect income and turn it over to the exempt organizations. Thus, if Section 101 (6) is construed as taxpayer requests, the express limitations in Section 101 (14) will be meaningless.

That Congress did not intend to exempt a business corporation is further shown by the limitations on deductions in Code Section 23 (q)(2).

3. There has been some difference of opinion expressed in the applicable decisions but we submit that the taxpayer is in error in contending that the majority

hold that destination of income rather than its source should be the controlling factor. It appears that cases which emphasize destination rely on the leading case of *Trinidad* v. *Sagrada Orden,* 263 U. S. 578, but in doing so have misinterpreted the Supreme Court's opinion. That case involved a religious organization and such fact was conceded by the Government. Thus its operations for profit were not only a minor part of its activities but closely connected with its religious enterprises. The Supreme Court did not indicate there that those organized for business and operating for financial gain should be given exemption.

There are only four cases which appear to make destination the sole test and two of these (*Roche's Beach, Inc.* v. *Commissioner,* 96 F. 2d 776 (C.A. 2d), and *Willingham* v. *Home Oil Mill,* 181 F. 2d 9 (C.A. 5th)) actually do not make destination the sole test for the taxpayer in each case acted as a medium through which the wholly exempt organization therein functioned. But in the other two cases (*C. F. Mueller Co.* v. *Commissioner,* 190 F. 2d 120 (C.A. 3d), and *Sico Co.* v. *United States,* 102 F. Supp. 197 (C. Cls.)) the taxpayers were regular business organizations with business purposes. Thus the courts there erred in allowing them exemption and in so doing misinterpreted the decisions relied on therein.

4. The legislative history does not support the taxpayer's contention. There is little, if any, value in the Congressional debates, on which taxpayer relies, but what there is indicates that Congress intended to give exemption only to institutions which actually have

religious, charitable or educational functions. This is shown in later enactments, especially in the additions to the law in 1950 which may be referred to because they did not change the existing law but merely clarified it.

ARGUMENT

THE TAX COURT CORRECTLY HELD THAT THE TAXPAYER IS NOT ENTITLED TO EXEMPTION UNDER SECTION 101 (6) OF THE INTERNAL REVENUE CODE.

A. Applicable Provisions of the Statute and Regulations

In order to claim exemption under Section 101(6) of the Internal Revenue Code (Appendix A, *infra*), a a corporation must show (1) that it has been "organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes", and (2) that no part of its net earnings inures to the benefit of any private shareholder or individual.[2] The longstanding Regulations issued pursuant to Section 101(6) makes it clear that these requirements constitute separate conditions and both are prerequisites to exemption. See Section 29.101(6)-1 of Treasury Regulations 111 (Appendix A, *infra*).

It is important to note that both requirements must be met because, as we shall point out below, some courts have held that a claim to exemption is to be determined entirely by the ultimate destination of the claimant's income. That is of course merely another way of saying that it is only the second statutory requirement

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[2] There is a third statutory requirement which prohibits the carrying on of propaganda to influence legislation but that will not be discussed as it does not appear that the taxpayer has been so engaged.

which is of any importance and that a corporation will be treated as if it were organized and operated for the required statutory purpose if its income is to be used for such purpose. Obviously that is not what the statute says and we cannot believe that Congress meant for the first requirement of Section 101(6) to be watered down and made meaningless in that way. Accordingly we shall begin our consideration here with the first requirement as to which it is our position that the taxpayer has not and cannot satisfy its terms, and that was also the holding of the Tax Court.

The taxpayer states (Br. 15) that the Tax Court did not specifically indicate the basis for denying the exemption but we do not agree. The Tax Court made it very clear that it had not changed its thinking on Section 101 (6) in spite of a reversal of its decision in *C. F. Mueller Co.* v. *Commissioner,* 14 T.C. 922, by the Court of Appeals for the Third Circuit. (See 190 F. 2d 120.) Thus the Tax Court took the same position here that it has frequently announced in other cases including *Danz* v. *Commissioner,* 18 T.C. 454, which is now pending in this Court on taxpayer's appeal, and in which the Tax Court stated the basis for its denial of exemption as follows (p. 461):

> This Court has held that where a corporation was organized and operated to carry on a regular business under circumstances similar to those here present, it is not exempt by section 101 (6) because it was not organized and operated "exclusively" for the purposes mentioned in that provision.

It will be seen that the Tax Court, in the *Danz* case, emphasized the word "exclusively" and we think that it should be emphasized. However the word has been largely ignored by those who place their reliance on the destination of the income rather than its source. But when the word "exclusively" is given its necessary meaning, it becomes apparent that a claimant does not meet the statutory requirements merely by showing that it has one purpose which is within those named in Section 101 (6). Instead it must be shown that such purpose is absolutely the only one for which it was organized.

The necessity of this was pointed out in *Better Business Bureau* v. *United States,* 326 U. S. 279, in which it was held that the taxpayer was not an educational organization and so not exempt from employment taxes under a statutory provision containing the same language as Section 101 (6). There, the Supreme Court said (p. 283):

> Even the most liberal of constructions does not mean that statutory words and phrases are to be given unusual or tortured meanings unjustified by legislative intent or that express limitations on such an exemption are to be ignored. * * *
>
> In this instance, in order to fall within the claimed exemption, an organization must be devoted to educational purposes exclusively. *This plainly means that the presence of a single non-educational purpose, if substantial in nature, will destroy the exemption regardless of the number or*

importance of truly educational purposes. * * * (Italics supplied.)

Accordingly, even if we take the most favorable view for the taxpayer here and assume that it did have a purpose acceptable under Section 101 (6), it cannot meet the statutory requirement for it also had a business purpose. Indeed, under our interpretation of taxpayer's articles of incorporation, taxpayer actually had only one purpose and that was a purpose to carry on a commercial business. We are of course aware that the articles of incorporation state that the "general nature of the business proposed to be transacted" is "To foster and promote Christian, religious, charitable and educational enterprises". (Appendix B, *infra.*) But that statement does not mean that the taxpayer was intended to operate as a religious, educational or charitable organization. Instead, it is evident that the organizers of taxpayer intended only that the net profits from various business activities would be turned over to religious, educational or charitable organizations. Thus we think it is evident that taxpayer's sole function is the carrying on of business for profit, and that it cannot be said that taxpayer itself has a religious, charitable or educational function. Certainly there is absolutely nothing in the articles of incorporation authorizing or requiring the taxpayer to undertake religious, charitable or educational work itself. On the other hand, the articles set forth a detailed description of the kind of commercial business the taxpayer is to engage in. See Article III of the Articles of Incorporation (Appendix B, *infra.*)

Thus, by the broad business powers granted, it seems evident that the taxpayer's organizers intended its sole function to be the transaction of commercial business.

We submit that since the taxpayer does not itself have a religious, charitable or educational function to perform, it does not meet the requirements of Section 101 (6). But, even if we are wrong in this interpretation, and this Court holds that the taxpayer does have one function or purpose which is required by the statute, it still should be denied exemption for, as we have pointed out, it also has a business purpose. This being so, it cannot properly be said that the taxpayer was organized *exclusively* for a religious, charitable or educational purpose. And the same is even more apparent as to taxpayer's operations during the taxable periods here.

The taxpayer's principal activities have not been religious, charitable or educational. Indeed such activities have not had even the remotest connection with any religious, charitable or educational enterprises.[3] This must be admitted because the record shows (R. 33-35) that the taxpayer has been actively engaged in four separate business enterprises, namely, farming, selling of real estate lots, selling of sport clothes, and a construction business. In this respect, the situation is the same as that in *Bear Gulch Water Co.* v. *Commissioner,* 116 F. 2d 975 (C.A. 9th), certiorari denied,

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[3] The Tax Court found that the taxpayer had rendered consultative services to some beneficiaries and had assisted in planning two church building programs. (R. 37.) But these services are clearly a minor part of its activities and so must be treated as merely incidental to its principal business activities.

314 U. S. 652. It will be recalled that the taxpayer there was a corporation wholly owned by the Regents of the University of California but this Court nevertheless denied it exemption and in doing so pointed out that its business was "a business enterprise conducted for gain". (P. 977.)

As that is also true here, it is evident, as we have already stated, that the most which can be said in taxpayer's favor is that it was organized and operated for dual purposes, i.e., (1) to engage in business for profit and (2) to turn over its profits to such religious, charitable or educational organizations as taxpayer's members may select from time to time. Consequently, even if we concede that there may be two purposes here, taxpayer's case still falls far short of being one in which a corporation has been *organized* and *operated exclusively* for one of the required purposes designated by Congress in Section 101 (6).

The facts here are very similar to those in *United States* v. *Community Services,* 189 F. 2d 421 (C.A. 4th), certiorari denied, 342 U. S. 932, in which exemption was denied to a corporation which was actively engaged in various business enterprises but claimed that it was a charitable organization because its charter and by-laws provided for its net earnings to go to charitable institutions. In denying taxpayer's claim, the court there said (pp. 424-425):

> Taxpayer was, in effect, organized and operated for two purposes: (1) to engage in commercial business, for profit, and (2) to turn over the profits realized from its commercial activities to chari-

> table organizations. The second purpose is charitable; the first purpose clearly is not. To qualify for the exemption here, the corporation must be "organized and operated *exclusively* for * * * charitable * * * purposes". * * *
>
> * * * not one of taxpayer's *activities* was charitable. On the contrary, these activities were all commercial.
>
> For tax-exemption purposes, the charitable nature of the distributees of its income cannot be attributable to the taxpayer. The corporation earning the income and claiming the exemption, rather than the recipients of the income, must be organized and operated exclusively for charitable purposes. Otherwise a purely commercial corporation could claim the exemption, if all its stock were owned by an exempt corporation, which would receive, as dividends, all the net earnings of the commercial corporation. Clearly this is not the law. * * *

It will be seen that the Fourth Circuit adopted the view that the taxpayer there had two purposes which is contrary to our principal contention here as we think there is in fact only one purpose. But even if we agree as to corporations organized like the one there, it still is clear, as the court brought out so forcefully, that a business purpose precludes tax exemption. It should also be noted that the taxpayer's position in the *Community Services* case was stronger than that of the taxpayer here for the corporate charter

there specifically required all of taxpayer's net profits to "be devoted exclusively to religious, charitable, scientific, literary and/or educational purposes", and the by-laws contained the same provision. (p. 423.) But there is no provision in the articles of incorporation here as to how the taxpayer's net income is to be used. Instead there is only a general provision to "foster and promote" religious, charitable and educational enterprises.

Since the taxpayer has not met the first requirement of Section 101 (6), it is not helped by the fact that it may have met the second requirement, namely, that no net earnings inure to private individuals during the taxable periods. Furthermore, although we will assume that the taxpayer has met the second requirement, we think it proper in considering taxpayer's organization to point out that it is entirely possible that its net earnings may inure to private individuals in the future because there is no prohibition in the articles of incorporation either against such inurement of current earnings or against the taxpayer's assets reverting to a private individual in the event that taxpayer is liquidated at the end of its designated term of 25 years. Also the taxpayer may not only amend or repeal any provision in the articles of incorporation but the Tax Court found (R. 36) that the matter of distributing earnings is one entirely within the discretion of the taxpayer's officers and directors. Moreover, although the taxpayer had net income (above net losses) of $82,683.14 during the taxable periods here, only $6,550 was actually distributed to any beneficiaries. It is of

course up to the Eatons when those earnings will be distributed as they have been in control and will remain so during their lifetime. We enumerate these facts not only to show the possibility of net earnings being accumulated or diverted from religious and educational enterprises but also to show that taxpayer's organization and operations are permeated with what the Supreme Court described in the *Better Business Bureau* case, *supra,* p. 283, as a "commercial hue", and that should preclude allowance of exemption under Section 101(6).

B. The Correctness of the Tax Court's Interpretation of Section 101(6) is Shown by Other Statutory Provisions.

The Tax Court's decision here is confirmed by Section 101 (14) of the Internal Revenue Code (Appendix A, *infra*). In that subdivision, Congress addressed itself to situations in which a corporation, which does not itself qualify for exemption under subdivision (6) or one of the other subdivisions of that section, dedicates its income to another organization which does qualify. Section 101 (14) exempts —

> Corporations organized for the exclusive purpose of holding title to property, collecting income therefrom, and turning over the entire amount thereof, less expenses, to an organization which itself is exempt from the tax imposed by this chapter; * * *

Thus, Congress was fully aware of the possibility that the net earnings of an organization which is not itself organized and operated exclusively for exempt pur-

poses might be destined for other organizations which were so organized and operated, such as an exempt church or university. Yet it saw fit to limit the exemption in such cases to corporations and only to those whose function was that of "holding title to property, collecting income therefrom, and turning over the entire amount thereof, less expenses", to exempt organizations. When Section 101 (14) is read together with Section 101 (6), as it must be (*Better Business Bureau* v. *United States, supra; Keystone Automobile Club* v. *Commissioner,* 181 F. 2d 402 (C.A. 3d)), it is manifest that Congress intended to accord tax exempt status to an organization on the basis of its own purposes and activities, not those of the recipients of its income, except in one type of situation—where a corporation serves merely as a holding and collecting medium for exempt organizations.

As the Fourth Circuit stated in *Community Services, supra,* p. 425:

> Had Congress intended to accord tax exempt status to a corporation, regardless of the nature of its own activities, solely because its profits are distributed to exempt organizations, it would have been an easy matter to say this, simply and clearly.

Instead, in Section 101 (14) Congress carefully circumscribed the exemption of distributing organizations by exempting only corporations whose exclusive purpose is of "holding title to property, collecting income therefrom, and turning over the entire amount thereof, less expenses" to exempt organizations.

To construe Section 101 (6) as exempting any organization whose income is destined for exempt organizations is to render meaningless the express limitations contained in Section 101 (14). Unless the requirements of Section 101 (14) are to be discarded as sheer surplusage, the conclusion is inescapable that organizations engaged in ordinary business activities, as was the taxpayer here, are not entitled to exemption under Section 101 (6) merely because their profits inure to the benefit of exempt organizations. See *Bear Gulch Water Co.* v. *Commissioner, supra; Gagne* v. *Hanover Water Works Co.,* 92 F. 2d 659 (C.A. 1st); and *Universal Oil Products Co.* v. *Campbell,* 181 F. 2d 451 (C.A. 7th), certiorari denied, 340 U. S. 850. As Judge Learned Hand stated in his dissenting opinion in *Roche's Beach, Inc.* v. *Commissioner,* 96 F. 2d 776, 779 (C.A. 2d)—

> The purpose of subdivision 14 was to tax all business income, however destined, unless the company was really not in busines at all. * * *

Also, in *Gagne* v. *Hanover Water Works Co., supra,* in which a corporation claimed exemption under subdivision (14), the court there, in denying exemption, explained (p. 661):

> The statute exempts only those corporations organized (incorporated) for the exclusive purpose of holding title to property, collecting income therefrom, and turning the entire amount thereof, less expenses, to an organization which is itself exempt * * *. The powers granted by its [taxpayer's] charter and the acts done under them disclose that

> it was authorized to engage and engaged in business activities like any domestic business corporation operating a water works plant for profit. It surely was not organized for the exclusive purpose of holding title to property and in fact it did not limit its activities to such purpose.

Thus the taxpayer in that case, like the taxpayer here, was not only authorized to engage but was engaged in regular business activities yet it claimed exemption because its earnings would go to Dartmouth College and the Village of Hanover. However its claim was not allowed.

That Congress did not intend to exempt a business corporation from tax merely because its net income is distributable to a tax exempt organization is also confirmed by Code Section 23 (q)(2) (Appendix A, *infra*) which limits allowable deductions by a corporation on account of contributions to organizations described in Section 101 (6) to an amount not exceeding 5 per cent of its net income. This section too would become meaningless if, as taxpayer argues, the entire net income of a business corporation escapes tax merely because the income is destined for tax exempt organizations.

C. Decisions Involving a Claim to Tax Exemption Under Section 101 of the Internal Revenue Code.

Taxpayer asserts (Br. 20) that "A majority of jurisdictions" considering the question here have held "that the destination of the income is more significant than its source". Also in this connection taxpayer

implies (Br. 21) that such cases as *C. F. Mueller Co.* v. *Commissioner,* 190 F. 2d 120 (C.A. 3d), and *Sico Co.* v. *United States,* 102 F. Supp. 197 (C. Cls.) (in which exemption was allowed), announced "the general rule" and that this Court indicated its agreement with the alleged rule in *Squire* v. *Students Book Corp.,* 191 F. 2d 1018, "although it did not expressly so hold in that case". We must take issue with the taxpayer that there is a "general rule" supporting taxpayer's contention here or that this Court has indicated that it approves the decision in the *Mueller* case which taxpayer cites as setting forth the views of the majority.

In the *Squire* case it was held that an incorporated book store which was owned by Washington State College and whose earnings were entirely devoted to the purposes of that institution was exempt under Section 101 (6) of the Internal Revenue Code. In discussing the issue before it, this Court did make the statement that most of the circuits confronted with the issue here appear to have applied the ultimate destination test in determining the question of exemption but the Court then stated in conclusion (p. 1020):

> *Resolution of the case before us does not depend wholly on the ultimate destination of the taxpayer's profits.* The business enterprise in which taxpayer is engaged obviously bears a close and intimate relationship to the functioning of the College itself. (Italics supplied.)

Thus it is evident that this Court was of the opinion that the book store there was organized and operated

to aid the college in its educational projects. Consequently the *Squire* case is distinguishable in that respect from the instant case, and we do not consider that case as determining what should be done in a case like the instant one where the taxpayer is not engaged in an educational or other approved enterprise. We are supported in our opinion that the question is still an open one by this Court's statement in the *Squire* case that it had made "no definite pronouncement on the subject". (P. 1020.)

It is true, as this Court pointed out in the *Squire* case, that opposite conclusions have been reached in the *Community Service* case, *supra,* and the *Mueller* case and that varying views have been expresed in other cases and that this has led to some confusion. Upon examination of these cases, it will be seen that most of them rely on the leading case of *Trinidad* v. *Sagrada Orden,* 263 U. S. 578, and we call special attention to that case here because the Supreme Court's opinion therein appears to be the basis for the view that destination rather than source of income should be the test in cases like the instant one, but we do not think such a conclusion is warranted when the opinion is correctly interpreted.

In the *Sagrada Orden* case, a religious organization that was otherwise tax exempt undertook as a minor part of its activities to sell wine and chocolate to its member churches, from which activities it received a trivial amount of income. The Government took the position that these activities deprived the organization of its tax exempt status, because it was not "operated exclusively" for religious purposes. In holding that

the organization did not lose its exemption, the Supreme Court in its opinion (p. 581) used language suggesting that the exemption depended not upon the "source of income", but rather upon its "destination". However the Court noted (p. 581) that such "limited trading, if it can be called such, is purely incidental to the pursuit of those [religious] purposes, and is in no sense a distinct or external venture". The crux of its opinion is to be found in the following language (p. 582):

> As respects the transactions in wine, chocolate and other articles, we think they *do not amount to engaging in trade in any proper sense of the term. It is not claimed that there is any selling to the public or in competition with others.* The articles are merely bought and supplied for use within the plaintiff's own organization and agencies—some of them for strictly religious use, and the others for uses which are purely incidental to the work which the plaintiff is carrying on. That the transactions yield some profit is in the circumstances a negligible factor. *Financial gain is not the end to which they are directed.* (Italics supplied.)

The plain implication of the Supreme Court's decision in the *Sagrada Orden* case (and its later decision in the *Better Business Bureau* case, *supra*) is that a corporation "selling to the public or in competition with others" for "financial gain" is not within the exempt class, even though it also performs tax exempt activities.

Certainly those who rely on the *Sagrada Orden* case must not be allowed to overlook the fact that the taxpayer there was not a business corporation and that the Government had conceded that it had been both organized and operated for religious purposes. Obviously whatever else may be said about that case, it was those significant facts which are the basic reasons for the decision. But in many of the subsequent cases involving Section 101 (6) the claimants have not been in a position to make such a showing or anything comparable to it. Furthermore, it will be seen, although some courts have referred to the ultimate destination of the income, there have often been other factors which support taxpayer's claim to exemption. Actually there are only four cases which even appear to allow exemption solely because of the ultimate destination of its income. These cases are *Roche's Beach, Inc.* v. *Commissioners, supra; Willingham* v. *Home Oil Mill*, 181 F. 2d 9 (C.A. 5th), certiorari denied, 340 U. S. 852; *C. F. Mueller Co.* v. *Commissioner, supra;* and *Sico Co.* v. *United States, supra.* Moreover, as we shall show below, the first two cases named do not actually make destination the sole test for exemption.

All of the four cases just referred to misinterpret and misapply the *Sagrada Orden* case and are essentially in conflict with this Court's decision in *Bear Gulch Water Co.* v. *Commissioner, supra*, and with the following: *Stanford University Book Store* v. *Helvering*, 83 F. 2d 710 (C.A.D.C.); *Universal Oil Products Co.* v. *Campbell*, 181 F. 2d 451 (C.A. 7th), certiorari denied, 340 U. S. 850; *United States* v. *Community Services, supra*; cf. *Gagne* v. *Hanover Water Works Co., supra.*

The four decisions are also in conflict with decisions holding that even an organization which itself carries on a charitable or other approved activity is not exempt if it has an additional purpose which is not charitable. See, e.g., *Better Business Bureau* v. *United States,* 326 U. S. 279; *Smyth* v. *California State Automobile Ass'n,* 175 F. 2d 752 (C.A. 9th), certiorari denied, 338 U. S. 905; *Chattanooga Auto. Club* v. *Commissioner,* 182 F. 2d 551 (C.A. 6th).

In *Roche's Beach, Inc.* v. *Commissioner, supra,* the taxpayer was a corporation organized as the medium through which a wholly-exempt charitable foundation was to operate and the will of the testator who provided for such corporation stated that all of the income therefrom must be used for charitable purposes. A somewhat similar situation existed in the *Home Oil Mill* case and, in granting exemption, the court stated there that (p. 10)—

> If it is possible for a religious, charitable, and educational trust to operate an industry through a corporate agency, and be exempt under Section 101 (6) of Title 26 U.S.C.A., the appellant is entitled to such exemption.

Consequently it is obvious that in the cases of *Roche's Beach* and *Home Oil Mill* the decisions resulted in large part from the fact that in each instance the corporation involved, although a separate entity, was intended to be and was an operating medium for an exempt organization which owned all its stock. What the courts there really did was to consider a charitable trust and its operating medium as one, attributing to

the operating medium the functional charitable purposes of the exempt charitable trust. This Court apparently did the same thing in *Squire* v. *Students Book Corp., supra,* where there was some factual basis for doing so.

Conversely, exemption has been denied because of the lack of such a relationship. *Stanford University Book Store* v. *Helvering, supra,* involved a cooperative association organized for the purpose of carrying on a general mercantile business for the accommodation of the students and faculty of Leland Stanford Junior University. The Court of Appeals for the District of Columbia there stated (p. 712):

> We think that the record conclusively shows that the association is not "a corporation organized and operated exclusively for educational purposes." It must be remembered that the association is not, in contemplation of law, a division or part of the university. The university as such does not own any interest in the association, is not responsible for its debts, is not entitled to any part of its earnings, and takes no part in conducting and managing its affairs. The two institutions are separate legal entities and *therefore the attributes of the university cannot be attributed to the association,* nor can the latter claim to be an educational institution * * *. (Italics supplied.)

In the present case, as in the case just cited, there is no basis for attributing functional religious, charitable or educational purposes to the taxpayer. There is no relationship between the taxpayer and any exempt

organization or between the taxpayer's activities and those of any exempt organization. All we have is a corporation whose profits are ultimately to be distributed to such organization as taxpayer's officers decide and it is within their discretion whether they distribute anything. Thus no specific organization has a right to receive any portion of the taxpayer's income at any time.

Thus, so far as we are aware, the *Mueller* and *Sico Co.* cases are the only ones which hold that an organization is entitled to exemption solely because of the ultimate destination of its profits. In neither of those cases was the organization involved an operating medium of an exempt organization through stock ownership or otherwise (although *Mueller* was later to become one). Thus there was no basis for attributing functional charitable activities to the organizations therein but, as we have pointed out, a functional charitable activity is a condition to exemption under Section 101 (6). Certainly that is the meaning of the first requirement therein, namely, that the taxpayer claiming exemption must be "organized and operated exclusively" for religious, educational or charitable purposes. See *United States* v. *Community Services, supra; Bear Gulch Water Co.* v. *Commissioner, supra; Universal Oil Products Co.* v. *Campbell, supra;* cf. *Gagne* v. *Hanover Water Works, supra; Sun-Herald Corp.* v. *Duggan,* 160 F. 2d 475 (C.A. 2d).

It should be noted also that most of the cases cited in the *Mueller* opinion were cases in which the taxpayer-organization was *itself* engaged in a functional charitable activity. See *Debs Memorial Radio Fund* v.

Commissioner, 148 F. 2d 948 (C.A. 2d); *Bohemian Gymnastic Ass'n Sokol of City of N. Y.* v. *Higgins,* 147 F. 2d 774 (C.A. 2d); *Commissioner* v. *Orton,* 173 F. 2d 483 (C.A. 6th); *Commissioner* v. *Battle Creek,* 126 F. 2d 405 (C.A. 5th). In all of those cases except *Debs Memorial Radio Fund* the taxpayer's commercial activity was incidental to its charitable activity, as in the *Sagrada Orden case. In Debs Memorial Radio Fund* the commercial activity, consisting of accepting radio advertising, was not merely incidental to the taxpayer's charitable activity but on the other hand was related to it and was necessary.

D. Legislative History

We submit that the language of Section 101 (6) is so clear that there is no need to refer to the legislative history. However, as taxpayer has done so, we shall also comment on it. Taxpayer asserts (Br. 27-28) that the early legislative history of this section indicates that a corporation organized for profit can be exempt provided (1) that it is not organized for individual profit and (2) that all the profits are devoted to religious, charitable or educational purposes. We cannot agree, particularly as it is clear that by such statement taxpayer means for us to infer that Congress intended to include ordinary business organizations if they devote their income to religious, charitable or educational institutions. It should be noted here that that portion of the proposed amendment to the 1909 Act to which taxpayer refers (Br. 23-27), and which used the language "all the profit of which is in good faith devoted" to the approved purposes, was omitted

from the final enactment. Nevertheless the omitted language appears to be what taxpayer is relying on. It cannot properly do so of course, but even if that language had been left in the law, taxpayer's interpretation would still be wrong.

Furthermore it is apparent, from the Senate debate from which the taxpayer quotes, that in considering tax exemption, the Senators had in mind organizations which actually had a religious, charitable or educational function to perform such as the Methodist Publishing Company referred to. (Br. 25.) Trinity Church of New York was another institution mentioned in the same debate, although taxpayer does not point that out. In view of these examples discussed by the Senators and of their failure to refer to ordinary businesses which might distribute profits to charitable or other approved institutions, we think it is evident that Congress did not mean to include such organizations as the taxpayer here.

The Committee Reports are silent on the particular provision involved here until 1935. In that year the legislative intent with respect to Section 101 (6) was affirmatively reflected when the language of Section 101 (6) was adopted in Section 811 (b)(8) of the Social Security Act, c. 531, 49 Stat. 620. The Committee Reports accompanying that Act state (H. Rep. No. 615, 74th Cong., 1st Sess., p. 33 (1939-2 Cum. Bull. 600, 607); S. Rep. No. 628, 74th Cong., 1st Sess. p. 54 (1939-2 Cum. Bull. 611, 621)):

> The organizations which will be exempt from such taxes are churches, schools, colleges, and other

educational institutions not operated for private profit, the Y.M.C.A., the Y.W.C.A., the Y.M.H.A., the Salvation Army, and other organizations which are exempt from income tax under Section 101 (6) of the Revenue Act of 1932.

The provisions added by the Revenue Act of 1950, c. 994, 64 Stat. 906, also clearly reflect the Congressional intent and understanding that Section 101 (6) does not exempt an organization to which a functional charitable activity cannot even be attributed. For pertinent portions of such provisions see Appendix A, *infra.* We are aware that our taxable periods are prior to 1950 but we refer to the 1950 Act because subsequent legislation may be considered to aid in the interpretation of prior legislation. See *Great Northern Ry. Co.* v. *United States,* 315 U. S. 262, 277; *Brewster* v. *Gage,* 280 U. S. 327, 337. Moreover it has been specifically held in *United States* v. *Community Services, supra,* that the provisions of the 1950 Act just referred to did not change the existing law but were merely clarifying.

The provisions of the 1950 Revenue Act implementing Code Section 101 represent the response of the Congress to the recommendations of the President and the Treasury. Section 301 (a) of the Act (Appendix A, *infra*) subjects to tax any "unrelated business net income", and subsection (b) (Appendix A, *infra*) taxes "Feeder Organizations".

The House Ways and Means Committee Report states that the provision taxing the unrelated business net income of organizations which otherwise meet the requirements of Section 101 (6) is aimed at "unfair

competition". H. Rep. No. 2319, 81st Cong., 2d Sess., pp. 36-37 (1950-2 Cum. Bull. 380, 408-409). Significantly, with respect to "Feeder Organizations", i.e., those whose earnings are payable to tax exempt organizations, the Report states (pp. 41-42, 124 (1950 Cum. Bull. 412, 469)):

> Section 301 (b) of your committee's bill provides that no organization operated primarily for the purpose of carrying on a trade or business (other than the rental of real estate) for profit shall be exempted under section 101 merely on the grounds that all of its profits are payable to one or more organizations exempt from tax under this section.
> * * *
>
> The effect of this amendment is to prevent the exemption of a trade or business organization under section 101 on the grounds that an organization actually described in section 101 receives the earnings from the operations of the trade or business organization. *In any case it appears clear to your committee that such an organization is not itself carrying out an exempt purpose.* Moreover, it obviously is in direct competition with other taxable businesses. This amendment applies only with respect to taxable years beginning after December 31, 1950. No implications should be drawn from it as to the present tax status of such organizations.

* * * * *

> The determination of the tax treatment of such feeder organizations for taxable years beginning prior to January 1, 1951, is to be made as if this subsection of the bill had not been enacted and *without inference drawn from the fact that the amendment made by this subsection of the Bill is not expressly made applicable to such taxable years.* In the area covered by this amendment there has been litigation as to the application of such a rule under existing law (cf. *Roche's Beach, Inc.* v. *Commissioner* (C.C.A. 2, 1938), 96 F. (2d) 776; *Universal Oil Products Co.* v. *Campbell* (C.A. 7, 1950), 181 F. (2d) 451; *Willingham* v. *Home Oil Mill* (C.A. 5, 1950), 181 F. (2d) 9; *C. F. Mueller Co.,* 14 T.C. No. 111-½ (May 25, 1950). *The amendment is intended to show clearly what, from its effective date, the rule is to be,* without disturbing the determination in present litigation of the rule of existing law. (Italics supplied.)

See also S. Rep. No. 2375, 81st Cong., 2d Sess., pp. 35-36 (1950-2 Cum. Bull. 483, 509).

Thus it is plain from the provisions of the 1950 Revenue Act and the Committee Reports that, in expressly providing that business organizations are not exempt because their profits are payable to an exempt organization, Congress was clarifying and not changing the law; and that it undertook such clarification because of litigation in this area. The statements in the Report that "In any case it appears clear to your committee that such an organization is not itself carrying out an exempt purpose", and that the amendment "is

intended to show clearly'' what the rule is to be, effectively repudiate the construction of the statute contended for by the taxpayer here.

CONCLUSION

The decision of the Tax Court is correct and should be affirmed.

Respectfully submitted,

H. Brian Holland,
Assistant Attorney General.

Ellis N. Slack,
Louise Foster,
Special Assistants to the Attorney General.

February, 1954.

APPENDIX A

Internal Revenue Code:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(q) [as amended by Sec. 125 of the Revenue Act of 1942, c. 619, 56 Stat. 798, and Sec. 114 of the Revenue Act of 1943, c. 63, 58 Stat. 21] *Charitable and Other Contributions by Corporations.*—In the case of a corporation, contributions or gifts payment of which is made within the taxable year to or for the use of:

* * * * *

(2) A corporation, trust, or community chest fund, or foundation, created or organized in the United States or in any possession thereof or under the law of the United States, or of any State or Territory, or of the District of Columbia, or of any possession of the United States, organized and operated exclusively for religious, charitable, scientific, veteran rehabilitation service, literary, or educational purposes or for the prevention of cruelty to children * * * no part of the net earnings of which inures to the benefit of any private shareholder or individual, and no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation; or

* * * * *

to an amount which does not exceed 5 percentum of the taxpayer's net income as computed without benefit of this subsection. * * *

* * * *

SEC. 54. RECORDS AND SPECIAL RETURNS.

* * * * *

(f) [as added by Sec. 117 of the Revenue Act of 1943, *supra*] Every organization, except as hereinafter provided, exempt from taxation under section 101 shall file an annual return, which shall contain or be verified by a written declaration that it is made under the penalties of perjury, stating specifically the items of gross income, receipts, and disbursements, and such other information for the purpose of carrying out the provisions of this chapter as the Commissioner, with the approval of the Secretary, may by regulations prescribe, and shall keep such records, render under oath such statements, make such other returns, and comply with such rules and regulations as the Commissioner, with the approval of the Secretary, may from time to time prescribe. No such annual return need be filed under this subsection by any organization exempt from taxation under the provisions of section 101—

(1) which is a religious organization exempt under section 101 (6); or

* * * * *

(4) which is an organization exempt under section 101 (6), if such organization is operated, supervised, or controlled by or in connection with a religious organization described in paragraph (1); or

* * * * *

(26 U.S.C. 1946 ed., Sec. 54.)

SEC. 101. EXEMPTIONS FROM TAX ON CORPORATIONS.

The following organizations shall be exempt from taxation under this chapter—

* * * * *

(6) Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, and no substantial part of the activities of which is carrying on propaganda, or otherwise atempting, to influence legislation;

* * * * *

(14) Corporations organized for the exclusive purpose of holding title to property, collecting income therefrom, and turning over the entire amount thereof, less expenses, to an organization which itself is exempt from the tax imposed by this chapter;

* * * * *

(26 U.S.C. 1946 ed., Sec. 101.)

Revenue Act of 1950, c. 994, 64 Stat. 906:

SEC. 301. INCOME OF EDUCATIONAL, CHARITABLE, AND CERTAIN OTHER EXEMPT ORGANIZATIONS.

(a) *Tax on Certain Types of Income.*—Supplement U of chapter 1 is hereby amended to read as follows:

"SUPPLEMENT U—TAXATION OF BUSINESS INCOME OF CERTAIN SECTION 101 ORGANIZATIONS

"SEC. 421. IMPOSITION OF TAX.

"(a) *In General.*—There shall be levied, collected, and paid for each taxable year begining after December 31, 1950—

"(1) upon the supplement U net income (as defined in subsection (c)) of every organization described in subsection (b)(1), a normal tax of 25 per centum of the supplement U net income, and a surtax of 20 per centum of the amount of the supplement U net income in excess of $25,000.

* * * * *

"(b) *Organizations Subject to Tax.*—

"(1) *Organizations taxable as corporations.*—The taxes imposed by subsection (a)(1) shall apply in the case of any organization (other than a church, a convention or association of churches, or a trust described in paragraph (2)) which is exempt, except as provided in this supplement, from taxation under this chapter by reason of paragraph (1), (6), or (7) of section 101. Such taxes shall also apply in the case of a corporation described in section 101 (14) if the income is payable to an organization which itself is subject to the tax imposed by subsection (a) or to a church or to a convention or association of churches.

* * * * *

"(c) *Definition of Supplement U Net Income.*—The term 'supplement U net income' of an organiza-

tion means the amount by which its unrelated business net income (as defined in section 422) exceeds $1,000.

* * * * *

"SEC. 422. UNRELATED BUSINESS NET INCOME.

"(a) *Definition.*—The term 'unrelated business net income' means the gross income derived by any organization from any unrelated trade or business (as defined in subsection (b)) regularly carried on by it, less the deductions allowed by section 23 which are directly connected with the carrying on of such trade or business, subject to the following exceptions, additions, and limitations:

* * * * *

"(b) *Unrelated Trade or Business.*—The term 'unrelated trade or business' means, in the case of any organization subject to the tax imposed by section 421 (a), any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 101, * * *

* * * * *

The term 'unrelated trade or business' means, in the case of a trust computing its unrelated business net income under this section for the purposes of section 162 (g)(1), any trade or business regularly carried

on by such trust or by a partnership of which it is a member.

* * * * *

(b) *Feeder Organizations.*—Section 101 is hereby amended by adding at the end thereof the following paragraph:

"An organization operated for the primary purpose of carrying on a trade or business for profit shall not be exempt under any paragraph of this section on the ground that all of its profits are payable to one or more organizations exempt under this section from taxation. For the purposes of this paragraph the term 'trade or business' shall not include the rental by an organization of its real property (including personal property leased with the real property)."

* * * * *

(26 U.S.C. 1946 ed., Supp. IV, Secs. 101, 421-422.)

SEC. 302. EXEMPTION OF CERTAIN ORGANIZATIONS FOR PAST YEARS.

(a) *Trade or Business Not Unrelated.*—For any taxable year beginning prior to January 1, 1951, no organization shall be denied exemption under paragraph (1), (6), or (7) of section 101 of the Internal Revenue Code on the grounds that it is carrying on a trade or business for profit if the income from such trade or business would not be taxable as unrelated business income under the provisions of Supplement U of the Internal Revenue Code, as amended by this Act, or if such trade or business is the rental

by such organization of its real property (including personal property leased with the real property).

* * * * *

SEC. 303. EFFECTIVE DATE OF PART I.

The amendments made by this part shall be applicable only with respect to taxable years beginning after December 31, 1950. The determination as to whether an organization is exempt under section 101 of the Internal Revenue Code from taxation for any taxable year beginning before January 1, 1951, shall be made as if section 301 (b) of this Act had not been enacted and without inferences drawn from the fact that the amendment made by such section is not expressly made applicable with respect to taxable years beginning before January 1, 1951.

Treasury Regulations 111, promulgated under the Internal Revenue Code:

SEC. 29.101(6)-1. *Religious, Charitable, Scientific, Literary, and Educational Organizations and Community Chests.*—In order to be exempt under section 101(6), the organization must meet three tests:

(1) It must be organized and operated exclusively for one or more of the specified purposes;

(2) Its net income must not inure in whole or in part to the benefit of private shareholders or individuals; and

(3) It must not by any substantial part of its activities attempt to influence legislation by propaganda or otherwise.

Corporations organized and operated exclusively for charitable purposes comprise, in general, organizations for the relief of the poor. The fact that a corporation established for the relief of indigent persons may receive voluntary contributions from the persons intended to be relieved will not necessarily deprive it of exemption.

* * * * *

Since a corporation to be exempt under section 101(6) must be organized and operated exclusively for one or more of the specified purposes, an organization which has certain religious purposes and which also manufactures and sells articles to the public for profit, is not exempt under section 101(6) even though its property is held in common and its profits do not inure to the benefit of individual members of the organization. * * *

APPENDIX B

Excerpts from Petitioner's Exhibit 8

ARTICLES OF INCORPORATION

of

RALPH H. EATON FOUNDATION

KNOW ALL MEN BY THESE PRESENTS:

That we, the undersigned, have this day associated ourselves together for the purpose of forming a corporation under and pursuant to the laws of the State of Arizona for purposes other than pecuniary

profit, and do hereby adopt Articles of Incorporation as follows;

ARTICLE I

The name of the corporation shall be:

RALPH H. EATON FOUNDATION

The names and post office addresses of the incorporators and original members are:

Names	Addresses
Ralph H. Eaton	Phoenix, Arizona
Frances M. Eaton	Phoenix, Arizona
Thomas H. Kent, Jr.	Phoenix, Arizona

ARTICLE II

The principal place within the State of Arizona at which the business of the corporation is to be transacted is in the City of Phoenix, County of Maricopa, State of Arizona, at which place the meetings of incorporators and members may be held. The corporation may have such other offices, either within or without the State of Arizona, as may from time to time be established by the Board of Directors and meetings of the Board of Directors may be held at any time or place.

ARTICLE III

The general nature of the business proposed to be transacted is as follows:

1. To foster and promote Christian, religious, charitable and educational enterprises.

2. To acquire by purchase, gift, devise, bequest, transfer, assignment or otherwise, and to buy, sell, deal in, receive, exchange, own, hold, rent, lease, grant, transfer, assign, convey, mortgage, encumber, deed in trust, pledge, hypothecate, give, alien, dispose of, manage, and control real and personal property of every kind and description as in connection with the purposes of this corporation and the promotion, maintenance, support and operation thereof may be expedient or necessary; to incur indebtedness and to execute and deliver written evidences thereof; to contract in the same manner and to the same extent as a natural person; to sue and to be sued and to defend in all courts and all places in all matters and proceedings whatsoever.

3. This corporation is one which does not contemplate pecuniary gain or profit to the members thereof and shall have no capital stock. It is empowered to purchase, hold, sell, assign, transfer, mortgage, pledge or otherwise dispose of shares of the capital stock of, or any bonds, securities, or evidences of indebtedness created by any other corporation or corporations of the State of Arizona or any other state or government and while the owner of such shares of stock, to exercise all the rights, powers and privileges of ownership, including the right to vote thereon.

To borrow money; to issue bonds, debentures or obligations of this corporation from time to

time for money borrowed or otherwise for the purposes and in the manner provided by law; and to secure the same by mortgage, pledge, deed of trust or otherwise.

The foregoing clauses shall be construed as both purposes and powers, and the enumeration of specific purposes and powers shall not be construed to limit or restrict in any manner the meaning of general terms or the general powers of the corporation, which is organized for the purpose of fostering and promoting by furnishing funds for contributing to and endowing Christian, religious, charitable and educational enterprises.

Article IV

[Omitted because it appears in the record, p. 30]

Article V

The time of the commencement of this corporation shall be the date of the filing of these articles of incorporation with the Arizona Corporation Commission and the recordation of certified copies thereof in the offices of the County Recorder of Maricopa County, Arizona, and it shall terminate twenty-five (25) years thereafter, unless it be renewed in manner provided by law.

Article VI

New members may be admitted to this corporation by a majority vote of the members and the

affairs of the corporation shall be conducted by a Board of Directors of not less than three (3) members nor more than seven (7) members as shall be determined by the by-laws of the corporation.

Article VII

The Board of Directors shall have authority among other things to make and alter the by-laws of this corporation.

Article VIII

The private property of the members and officers of this corporation shall be exempt from all corporate debts of any kind whatsoever.

Article IX

This corporation reserves the right to amend, alter, change or repeal any provision contained in these articles of incorporation in the manner now or hereafter prescribed by statute, and all rights conferred upon members herein are granted subject to this reservation.

Article X

The highest amount of indebtedness or liability, direct or contingent, to which the corporation shall at any time subject itself shall be limited only by an amount calculated in accordance with any rules or regulations promulgated by the Arizona Corporation Commission in compliance with the law of this state affecting non-profit corporations.

Article XI

The members of this corporation are:

Ralph H. Eaton
Frances M. Eaton
Thomas H. Kent, Jr.

New members may be admitted by a majority vote of the members at a meeting called for that purpose.

Ralph H. Eaton, Frances M. Eaton, and Thomas H. Kent, Jr. were elected directors of the said corporation at a meeting held at 403 1st Natl Bank Bldg., Phoenix, Arizona, on the 10th day of March, 1947.

The term of office of the director, Ralph H. Eaton, shall be for the duration of his natural life or until his resignation or incapacity to act. The term of office of the director, Frances M. Eaton, shall be for the duration of her natural life or until her resignation or incapacity to act. The term of office for any other director shall be for the period of two (2) years.

Directors of the corporation shall be elected at the annual meeting of the members of the corporation on the 1st Monday of February in each year beginning in the year 1948.

Article XII

This corporation shall have no members other than its directors, and the authorized number of such directors, subject to change at any time by a change in the by-laws, is three (3).

1. Each director shall serve until his successor is elected and qualified, or until his term of office is terminated as herein provided.

2. No person shall be elected or chosen as a director of this corporation unless and until he shall, before being so elected, in writing, same to be filed with and become a part of the records of this corporation, declare himself to have a heart-conviction, without any equivocation or mental reservation whatsoever, of the trugh [*sic*] of each and all of the statements contained in and composing the Doctrinal Statement contained in Article IV hereof. At or immediately before each annual meeting of the corporation, each director shall, in writing, same to be filed with and become a part of the records of this corporation, declare himself to have a heart-conviction, without any equivocation or mental reservation whatsoever, of the truth of each and all of the statements contained in and composing the Doctrinal Statement contained in Article IV hereof. Failure or refusal or neglect of any director so to do shall ipso facto forfeit his right to be or become or remain as such director; and by reason thereof his office as such director shall ipso facto and instanter be and become vacant.

Any director, who, upon the written request of a majority of the other directors to him delivered, shall, within ten (10) days from the receipt of such written request, fail or refuse or neglect to, in writing, same to be filed with and become a part of the records of this corporation, declare himself to have

a heart-conviction, without any equivocation or mental reservation whatsoever, of the truth of each and all the statements contained in and composing the Doctrinal Statement contained in Article IV hereof, shall ipso facto and instanter forfeit his right to be or become or remain as such director; and by reason thereof his office as such director shall ipso facto and instanter become vacant.

Article XIII

The Board of Directors shall regulate, govern and control all and singular the business affairs of this corporation.

In Witness Whereof, we, the undersigned, have made and executed the above articles of incorporation and subscribed our names hereto this 12th day of March, 1947.

(Signed) Ralph H. Eaton
Francis M. Eaton
Thomas H. Kent, Jr.

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